RECEIVED

AUG 2 6 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Telecommunications Act of 1996:	)	CC Docket No. 96-150
	)	
Accounting Safeguards Under the Telecommunications Act of 1996	)	

DOCKET FILE COPY ORIGINAL

NYNEX COMMENTS

The NYNEX Telephone Companies

Campbell L. Ayling

1111 Westchester Avenue
White Plains, N.Y. 10604
(914) 644-6306

Their Attorney

Dated: August 26, 1996

TABLE OF CONTENTS

SUMMARY

NYNEX responds herein to the FCC's NPRM addressing proposed measures to implement the accounting safeguards provisions of the Telecommunications Act of 1996 (the "Act"). The intent of the Act's sweeping changes is to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition. The FCC's objective in this docket is to protect against improper cost allocations, while allowing the BOCs and other incumbent LECs to realize their reasonable competitive advantages and ensuring that the consumers of those carriers' regulated telecommunications services are able to share in the carriers' economies of scope. NYNEX will show how the FCC can achieve its pro-competitive goals and not impose undue burdens or competitive disadvantages upon carriers like NYNEX in today's rapidly changing marketplace.

NYNEX will point out that FCC price cap regulation with no sharing/low-end adjustments has substantially weakened any link between interstate regulated costs and regulated rates (Section II). This has essentially eliminated any incentive for cost-shifting. In this environment, the FCC to the extent possible should forbear from applying, or waive Part 64 rules. As any link between regulated costs and rates becomes further weakened or broken, the FCC should ultimately eliminate its regulatory accounting and cost allocation rules.

To the extent the FCC retains its Part 64 cost allocation and affiliate transaction rules, NYNEX believes those existing rules more than satisfy the Act's accounting safeguards requirements. The existing FCC cost accounting safeguards have been quite effective in

precluding any potential cross-subsidy flowing from the telephone ratepayer. The FCC should thus adopt the minimal additional accounting provisions needed, if any, to effectuate the Act, and streamline its rules where possible. By minimizing regulatory burdens, this approach will avoid hampering NYNEX's ability to compete and discouraging integration that would benefit the telephone ratepayer, and this approach will help foster the development of a fully competitive marketplace.

Consistent with the above themes, NYNEX will specifically address various issues raised in the NPRM relative to safeguards for integrated operations and safeguards for separated operations (Section III). Thus, for example, NYNEX agrees with the Commission's tentative conclusion that existing Part 64 rules satisfy the Act's provisions precluding cross-subsidy in the context of integrated operations.

With respect to separated operations, the Commission should not apply any modifications to its affiliate transaction rules across the board, but rather only to those regulated/nonregulated transactions involving separate affiliates required by the Act. Furthermore, the Commission should not extend its asset transfer accounting rules to services. That is, the Commission should not require telephone companies to record outbound services at the higher of cost or fair market value, and inbound services at the lower of cost or fair market value. It would be costly and burdensome to attempt to do a study of the fair market value of each type of inter-affiliate service, especially since support services are provided on a mixed basis of outsourcing and internal resources already. NYNEX also recommends that the FCC continue to allow prevailing market price to be recorded for affiliate transactions as a reasonable benchmark of value. Further, NYNEX concurs with the Commission's classification of interLATA telecommunications affiliates as BOC nonregulated affiliates for purposes of affiliate transaction rules.

Finally, NYNEX demonstrates that the Commission should not expand the types of cost reallocations from regulated to nonregulated activities subject to exogenous treatment under price cap rules (Section IV). Such expansion would result in duplicative, inconsistent regulation that discourages beneficial integration. For example, NYNEX would strongly oppose any attempt to impose downward exogenous cost adjustments for new joint network investment where nonregulated costs were not previously allocated to the regulated area.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Telecommunications Act of 1996:	)	CC Docket No. 96-150
	)	
Accounting Safeguards Under the Telecommunications Act of 1996	)	

NYNEX COMMENTS

I. INTRODUCTION

The NYNEX Telephone Companies ("NYNEX") file these Comments in response to the Commission's Notice of Proposed Rulemaking ("NPRM") released July 18, 1996, in the above-captioned matter.

The NPRM addresses proposed measures to implement the accounting safeguards provisions of the Telecommunications Act of 1996 (the "Act"). The intent of the Act's sweeping changes is "to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition."[1] The FCC's objective in this docket is to protect against improper cost allocations, while allowing the BOCs and other incumbent LECs to realize their reasonable competitive

---

[1] See NPRM ¶ 1 & n. 2.

advantages and ensuring that the consumers of those carriers' regulated telecommunications services are able to share in the carriers' economies of scope.[2] NYNEX will show herein how the FCC can achieve its pro-competitive goals and not impose undue burdens or competitive disadvantages upon carriers like NYNEX in today's rapidly changing marketplace.

NYNEX will point out that FCC price cap regulation with no sharing/low-end adjustments has substantially weakened any link between interstate regulated costs and regulated rates (Section II). This has essentially eliminated any incentive for cost-shifting. In this environment, the FCC to the extent possible should forbear from applying, to waive Part 64 rules.[3] As any link between regulated costs and rates becomes further weakened or broken, the FCC should ultimately eliminate its regulatory accounting and cost allocation rules.

To the extent the FCC retains its Part 64 cost allocation and affiliate transaction rules, NYNEX believes those existing rules more than satisfy the Act's accounting safeguards requirements.[4] The existing FCC cost accounting safeguards have been quite effective in precluding any potential cross-subsidy flowing from the telephone ratepayer. The FCC should thus adopt the minimal additional accounting provisions needed, if any, to effectuate the Act, and streamline its rules where possible. By minimizing regulatory burdens, this approach will avoid hampering NYNEX's ability to compete and discouraging integration that would benefit the

---

2 See NPRM ¶ 7.

3 See 47 C.F.R. Part 64 Subpart I (Allocation of Costs); Sections 32.23 (Nonregulated activities), 32.27 (Transactions with affiliates), 43.21 (Annual Reports of carriers and certain affiliates), 43.22 (Quarterly Reports of communication common carriers) (referred to generally herein as Part 64 rules).

4 See NPRM ¶¶ 27, 64.

telephone ratepayer, and this approach will help foster the development of a fully competitive marketplace.

Consistent with the above themes, NYNEX will specifically address various issues raised in the NPRM relative to safeguards for integrated operations and safeguards for separated operations (Section III). Thus, for example, NYNEX agrees with the Commission's tentative conclusion that existing Part 64 rules satisfy the Act's provisions precluding cross-subsidy in the context of integrated operations.[5]

With respect to separated operations, the Commission should not apply any modifications to its affiliate transaction rules across the board, but rather only to those regulated/nonregulated transactions involving separate affiliates required by the Act. Furthermore, the Commission should not extend its asset transfer accounting rules to services. That is, the Commission should not require telephone companies to record outbound services at the higher of cost or fair market value, and inbound services at the lower of cost or fair market value. It would be costly and burdensome to attempt to do a study of the fair market value of each type of inter-affiliate service, especially since support services are provided on a mixed basis of outsourcing and internal resources already. NYNEX also recommends that the FCC continue to allow prevailing market price to be recorded for affiliate transactions as a reasonable benchmark of value. Further, NYNEX concurs with the Commission's classification of interLATA telecommunications affiliates as BOC nonregulated affiliates for purposes of affiliate transaction rules.

---

[5] See NPRM ¶ 27.

Finally, NYNEX demonstrates that the Commission should not expand the types of cost reallocations from regulated to nonregulated activities subject to exogenous treatment under price cap rules (Section IV). Such expansion would result in duplicative, inconsistent regulation that discourages beneficial integration. For example, NYNEX would strongly oppose any attempt to impose downward exogenous cost adjustments for new joint network investment where nonregulated costs were not previously allocated to the regulated area.

II. UNDER THE PRICE CAP REGIME, THE FCC SHOULD MOVE AWAY FROM PART 64 RULES NOT NECESSARY TO ACHIEVE ITS GOALS

It is not until near the end of the NPRM that the FCC specifically invites comment on the relevance of its price cap rules to the continued need for Part 64 and regulatory accounting rules.[6] That is, in Section IV of the NPRM, the Commission addresses price cap and Part 64 related issues and discusses their relation to the safeguards necessary to protect against improper cost allocations. The NPRM (at ¶ 124) seeks comment on whether eliminating the sharing obligations permanently for price cap carriers would eliminate the need for Part 64 processes in the regulation of these companies.

NYNEX believes this issue merits primary consideration in this proceeding. FCC price cap regulation with no sharing/low-end adjustments has substantially weakened any link between interstate regulated costs and regulated rates.[7] This has basically eliminated any incentive for cost-shifting. In the 1996 Annual Access Tariff Filing, NYNEX elected a productivity factor

---

[6] See NPRM ¶ 124.

[7] See LEC Price Cap Performance Review Order, CC Docket No. 94-1, 10 FCC Rcd 8961, ¶¶ 27-28, 274, 298-99 (1995).

option involving no sharing or low-end adjustments. As the Commission notes,[8] many price cap LECs have also selected this option. Accordingly, in the current FCC price cap environment, the Part 64 cost allocation rules have become far less relevant, and any residual relevance may soon disappear entirely.[9] Therefore, to the extent possible, the Commission should consider exercising its authority under Section 10 of the Communications Act to forbear from applying Part 64 to LECs subject to price cap regulation without sharing/low-end adjustments;[10] or, alternatively, should consider waiving the Part 64 rules in those instances under its Rule 1.3 authority. As any link between regulated rates and costs becomes further weakened or broken, the Commission should forbear from applying or completely remove its regulatory accounting and cost allocation rules.

The Commission notes that: "existing Part 64 cost allocation rules were developed when all local exchange carriers were subject to cost-based, rate-of-return regulation."[11] The Commission also recognizes that today price cap regulation is used to ensure that rates for

---

[8] See NPRM ¶ 124 & n. 254.

[9] The Commission is currently considering whether a pure price cap plan (i.e., no sharing/low-end adjustments), as it applied to AT&T, should be adopted for price cap LECs. CC Docket No. 94-1, Fourth Further Notice of Proposed Rulemaking, released September 27, 1995 (addressing the productivity offset or X-Factor in the LEC price cap plan).

[10] Under Section 10, the Commission is required to forbear from applying rules where, as here, the rules are not necessary to assure just and reasonable (and not unjustly or unreasonably discriminatory) rates, protection of consumers and the public interest.

[11] See NPRM ¶ 120; See Separation Of Costs Of Regulated Telephone Service From Costs Of Nonregulated Activities, CC Docket No. 86-111, 2 FCC Rcd 1298 (1987) (Joint Cost Order), 2 FCC Rcd 6283 (1987) (Joint Cost Reconsideration Order), 3 FCC Rcd 6701 (1988) (Joint Cost Further Reconsideration Order), aff'd sub nom. Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990). The Part 64 rules were designed to prevent cost shifting from nonregulated to regulated activities, and were never intended to be a basis for pricing. See Joint Cost Order, ¶¶ 33, 40.

interstate services are reasonable, and that many states have moved away from rate-of-return regulation by establishing temporary rate freezes or other price cap-like plans.[12] The FCC has recognized that its price cap regime is its primary means of guarding against any cross-subsidy leading to unreasonably high telephone rates.[13]

Further, the Commission highlights that: "Under pure price cap regulation, there would be few incentives to subsidize nonregulated services with revenues from regulated telecommunications services and the need for accounting safeguards to ensure against subsidies would be greatly diminished ...."[14] NYNEX believes that "pure" price cap regulation should be deemed to apply where, as was the case with AT&T, any sharing/low-end adjustments are inapplicable. In such a case, the link between interstate regulated costs and rates is so attenuated that Part 64 cost shifting rules are simply not justified. The Commission suggests (at NPRM ¶ 121) that the availability of exogenous cost adjustments and adjustments to productivity factors detract from a pure price cap plan.[15] However, these factors do not significantly link costs and rates and provide no basis for maintaining FCC Part 64 rules.[16]

---

[12] See NPRM ¶ 120..

[13] See, e.g., Telephone Company-Cable Television Cross-Ownership Rules, Video Dialtone Reconsideration Order, CC Docket No. 87-266, 10 FCC Rcd 244, ¶ 166 (1994).

[14] See NPRM ¶ 121.

[15] See also NPRM ¶ 6.

[16] In its X-Factor NPRM proceeding, the Commission is considering adopting a moving average, Total Factor Productivity-based productivity offset which would recognize almost all of the costs for which exogenous treatment would now be accorded, leaving exogenous cost treatment requests only to cost changes which are truly unique to individual LECs. See X-Factor NPRM, CC Docket No. 94-1, released September 27, 1995, ¶¶ 138-41; LEC Price Cap Performance Review Order ¶ 292. The proposed X-Factor in the LEC price cap formula is designed to capture total company productivity growth, including nonregulated activities provided on an integrated basis with regulated activities. See Christensen Study, as cited in

Elsewhere, the FCC and courts have observed that the imposition of a price cap regime substantially reduces, if not eliminates, any incentive to engage in anticompetitive cross-subsidization. For example, the Commission has noted that the AT&T price cap plan (with no sharing/low-end adjustments): "greatly reduces the incentives that AT&T may have to shift costs between its nonregulated operations and its carrier operations. Since AT&T's price caps are unrelated to AT&T's current costs, attempts by AT&T to manipulate the costs it records for affiliate transactions will not increase AT&T's rates."[17]

X-Factor NPRM at ¶¶ 22-25; Revised Christensen Study, appended to NYNEX Comments filed January 11, 1996 in response to X-Factor NPRM. As virtually all LEC nonregulated activities are provided on an integrated basis, any cost shifting between such activities and regulated activities would not impact such total company X-Factor. Such X-Factor also ensures that telephone ratepayers share in economies of scope and scale respecting regulated and nonregulated activities.

[17] Notice of Proposed Rulemaking, CC Docket No. 93-251, 8 FCC Rcd 8071, ¶ 101 (1993). See also BOC Safeguards Order, 6 FCC Rcd 7571, ¶¶ 13-14, 46, 55 (1991) (price cap "severs the direct link between regulated costs and prices" thereby "reduc[ing] the incentive for the BOCs to shift nonregulated costs to regulated services"; "[w]e find ... that these incentives [to shift costs] under price caps are much less significant than under rate of return regulation, for the BOCs are no longer automatically entitled to increase rates to recoup cost increases. LEC price cap regulation serves as an effective compliment to cost accounting, reporting, auditing, and enforcement safeguards."); Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, ¶ 104 (1989) (price cap regulation "substantially curtails the economic incentive to engage in cross-subsidization"); Video Dialtone Order, 7 FCC Rcd 5781, n. 236 (1992), Video Dialtone Reconsideration Order, 10 FCC Rcd 244, ¶¶ 179-82 (1994); BOCs' Joint Petition For Waiver Of Computer II Rules, DA 95-36, Order released January 11, 1995, ¶ 30. To the same effect, the D.C. Circuit has explained that under price caps there is no "reward for shifting costs from unregulated activities into regulated ones, for the higher costs will not produce higher legal ceiling prices." National Rural Telecom Ass'n v. FCC, 988 F.2d 174, 178 (D.C. Cir. 1993); see also U.S. v. Western Electric Co., 993 F.2d 1572, 1580-81 (D.C. Cir. 1993) cert. denied, 114 S. Ct. 487 (1993) (shift to price caps "reduces any BOC's ability to shift costs from unregulated to regulated activities"). Also, in California v. FCC, 39 F.3d 919 (9th Cir. 1994), the Court upheld the FCC's determination that its cost accounting rules and price cap regulation adequately prevent cross-subsidy of enhanced services.

Regarding State regulation,[18] NYNEX is subject to price or incentive regulation throughout most of its intrastate jurisdictions; and in its remaining jurisdictions such regulation is under active consideration by the State commission.[19] The Commission has made it clear that: "States are, of course, free to establish their own division of regulated and nonregulated costs."[20] Thus, the Commission need not rely on regulatory practices in the States in determining the continuing necessity for Part 64 rules in the federal jurisdiction.

Furthermore, the proliferation of intense competition with respect to regulated telephone services, particularly in NYNEX's region, has sharply curtailed any incentive for cost shifting to regulated activities. As the Commission notes: "[t]he incumbent local exchange carrier may be reluctant to increase rates for local exchange and exchange access service if the increases would induce competitive entry in the markets in which it would otherwise continue to have market power."[21] Further, the increasing level of competition, the achievement of price cap/incentive regulation in most of NYNEX's jurisdictions, and the rapid pace of technological change led NYNEX in 1995 to discontinue the use of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation." That is, NYNEX for financial reporting purposes has moved away from regulatory accounting by adopting accounting for nonregulated enterprises operating in a competitive environment. This again underscores irrelevance of

---

18 See NPRM ¶ 6.

19 NYNEX has achieved price regulation rather than rate of return regulation in New York, Massachusetts and Maine. See NYNEX 1995 Annual Report, p. 34. The Public Service Commission in Rhode Island approved a new Price Regulation plan in June 1996 which replaced a four year price regulation trial which expired in December 1995.

20 Joint Cost Reconsideration Order n. 235; Joint Cost Order ¶¶ 88, 90.

21 See NPRM ¶ 13.

regulatory accounting rules to regulated rates and prevention of cross-subsidy in the competitive marketplace.

III. THE FCC's CURRENT REGULATORY ACCOUNTING RULES, IF RETAINED, MORE THAN SATISFY THE ACT's ACCOUNTING PROVISIONS ON INTEGRATED AND SEPARATED OPERATIONS

A. The FCC's Cost Accounting Safeguards Have Been Effective

The FCC currently has in effect a comprehensive and proven system of cost accounting safeguards. These safeguards are designed to detect and prevent cross-subsidy from the telephone ratepayer of nonregulated activities whether offered directly by the telephone company or an affiliate. Under the Docket 86-111 joint cost rules, telephone companies must remove from regulated revenue requirements the fully allocated costs (and revenues) of nonregulated activities directly offered by those telephone companies.[22] Also under those rules, with respect to affiliate transactions, telephone companies must record services provided to or received from a nonregulated affiliate at the tariff rate, prevailing market price or fully allocated cost (in that order, as applicable); asset transfers are to be recorded (absent a tariff rate or prevailing market price) at net book cost or fair market value, whichever favors the telephone ratepayer.[23] In addition to these strict rules governing cost allocation and affiliate transactions, the Commission's cost accounting safeguards include: the filing and approval of Cost Allocation Manuals (CAMs); annual cost allocation audits of large telephone companies by independent

---

[22] See 47 C.F.R. Sections 32.23, 64.901.

[23] See 47 C.F.R. Section 32.27.

auditors, and staff review of those audits; reporting of detailed cost data in the Automated Reporting and Management Information System (ARMIS); and staff audits of carriers.[24]

These cost accounting rules, initially adopted in 1987, have been progressively strengthened over the years.[25] Moreover, the efficacy and benefits of these rules in precluding cross-subsidization have not only been confirmed previously by the Commission and Courts;[26] they are buttressed by the industry's successful experience operating under these rules.

Given this backdrop, the FCC approaches this docket not with a blank slate, but with a very effective in-place regime of cost accounting controls. Accordingly, NYNEX supports the Commission's tentative conclusion that these controls effectively guard against cross-subsidization flowing from the telephone ratepayer whether a nonregulated activity is offered by a BOC on an integrated or separated basis.[27]

---

24 See Joint Cost Order; Joint Cost Reconsideration Order; BOC Safeguards Order, 7 FCC Rcd 7571 (1991).

25 See BOC Safeguards Order, supra.

26 The Commission, for example, was "convinced" of their efficacy nearly half a decade ago, BOC Safeguards Order, 6 FCC Rcd at 7595, ¶ 54, and nothing to undermine the Commission's confidence has arisen since. The Court of Appeals for the D.C. Circuit has upheld these rules as "reasonably designed to prevent systematic abuse of ratepayers." Southwestern Bell Corp. v. FCC, 896 F.2d 1378, 1379 (D.C. Cir. 1990). The Department of Justice likewise has concluded that current FCC cost allocation rules "alleviate the concern that the [Bell Companies] will engage in anticompetitive cross-subsidization of unregulated activities with ratepayer revenues." The AT&T Consent Decree's Manufacturing Restriction: Hearing Before the Senate Subcomm. on Antitrust, Monopolies and Business Rights, 102d Cong., 1st Sess. 544 (1991) (Statement of James F. Rill, then Assistant Attorney General for Antitrust); see also National Telecommunications and Information Admin., U.S. Dep't of Commerce, The NTIA Infrastructure Report: Telecommunications in the Age of Information 233 (Oct. 1991) (FCC rules are "extensive and effective in controlling cross subsidy.") See also Section II, supra.

27 See NPRM ¶¶ 27, 64.

NYNEX also strongly agrees with the Commission's admonition that "those urging that we adopt more detailed accounting safeguards than those in our current rules or those specifically mandated by the 1996 Act bear a heavy burden of persuading us to adopt such safeguards."[28] Until the Commission reaches the point of dispensing with these cost accounting rules, the Commission should adopt only the minimum, if any, necessary additional safeguards in this area. This will also help minimize disparate regulatory burdens placed on incumbent BOCs which could inhibit robust and evenhanded competition.

B. No New Accounting Rules Are Required With Respect To Integrated Operations

With respect to activities involved in this NPRM that BOCs can offer on an integrated basis (i.e., within the telephone operating companies themselves), NYNEX concurs with the Commission's tentative conclusion that the existing Part 64 rules generally satisfy the Act's requirement of safeguards to ensure that those activities are not subsidized by subscribers to regulated telecommunications services.[29] There is certainly no basis for imposing any additional or stricter safeguards, since that would not be necessary to guard against cross-subsidy and would deter BOC pro-competitive, integrated activities that would benefit the ratepayer. Such action would frustrate the Congressional goal of a pro-competitive, deregulatory framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies.[30] The Commission should neither fashion overly restrictive rules nor

---

[28] See NPRM ¶ 12.

[29] See NPRM ¶ 27.

[30] See NPRM ¶ 1 & n. 2.

construe the meaning of the Act so narrowly, as to discourage BOCs from bringing greater choices and innovative services to consumers. Indeed, the Commission indicates a desire to preserve "the potential competitive benefits of the economies of scope that BOCs and other incumbent local exchange carriers could realize, benefits that constitute a major incentive for the BOCs and other incumbent local exchange carriers to enter or continue to participate in these markets."[31]

As noted, the Commission's goals include fostering competition and LEC effective participation in the lines of business involved herein. Under the Act, BOCs have various ways of participating in these businesses, including the use of facilities integrated with telephony in order to take advantage of economies of scope. On an economic basis, the BOC in deciding whether to enter such business will consider the additional or incremental costs to be incurred by the new business. To the extent the Commission's rules provide for an allocation of costs to the nonregulated business in excess of such additional or incremental costs, and remnants of rate of return regulation apply, this will distort economic decision making and may deter entry. This would be unfortunate because the regulated business will receive a benefit to the extent any costs (such as joint, common or overhead costs) are absorbed by nonregulated activities that do not cause those costs. This would also be unfortunate because the LECs, using integrated facilities, stand to offer services that will provide viable competitive alternatives to the benefit of American consumers.

---

[31] See NPRM ¶ 7.

The Commission should therefore avoid imposing regulatory or cost allocation burdens that could stand in the way of introducing competition in nonregulated markets. As long as the nonregulated area is bearing some allocation of costs not caused by nonregulated activities, the telephone ratepayer is better off. At a minimum, the Commission should not stray from its long-standing Part 64 policy "to promote an equitable sharing of common costs but ... not ... attempt through cost allocation rules to arrange a subsidy for regulated activities.[32]

Accordingly, NYNEX agrees that the current Part 64 rules more than satisfy the statutory requirement that competitive, nonregulated services are not to be subsidized by subscribers to regulated telecommunications services. There is no need to fundamentally alter the current system. It would be a waste of Commission and industry resources to fundamentally alter a system that works and may very well be eliminated altogether in the near future.

-- **Telemessaging:**

NYNEX agrees that telemessaging is an information service and the Part 64 rules provide sufficient safeguards for telemessaging services provided on an integrated basis.[33] However, the NPRM at ¶ 31 seems to misstate the requirements regarding reallocations of network investment. Paragraph 31 states that network investment must be allocated between regulated and nonregulated activities, and that telemessaging service may result in the reallocation of plant from regulated to nonregulated activities. The paragraph further states that such reallocation

---

[32] Joint Cost Order, ¶ 109. NYNEX agrees with the Commission that a policy which allocates all common costs to regulated services (see NPRM ¶ 9) is clearly untenable; however, rules which result in all of the benefits of economies of scope enuring to regulated activities are equally inappropriate.

[33] See NPRM ¶ 33.

must be made at undepreciated baseline cost and must include interest calculated at the authorized interstate rate of return. The joint cost rules require that shared network investment be allocated based on peak nonregulated usage over a three year period. The interest calculation pertains to reallocations of investment as a result of actual nonregulated usage exceeding the forecasted nonregulated usage, and the time period for which the interest is calculated is that period during which the actual usage exceeded the forecasted usage. Furthermore, it should be noted that for embedded plant, baseline cost is defined as "the depreciated original cost at the time the equipment was initially placed in joint use." Depreciated original cost means net book value.

-- InterLATA Telecommunications Services:

NYNEX thinks that BOC provision of interLATA telecommunications services on an integrated basis, to the extent allowed under Section 271, can and should be accommodated under existing rules (e.g., Corridor Service).[34] Such services need not be uniformly treated as nonregulated activities for the purposes of applying Part 64 rules. The approach taken in the BOC Out-of-Region Order[35] is a reasonable and cost effective method to protect local exchange service ratepayers from subsidizing competitive interexchange services provided by a BOC's nonregulated affiliate (see infra). However, a parallel approach need not be adopted in the context of integrated operations since the FCC's Part 36, Part 69 and price cap rules provide effective safeguards. In no event would further modification of the Part 64 rules be necessary to accommodate these services. Creating a separate category for regulated services other than local

---

34 See NPRM ¶ 39.

35 CC Docket No. 96-21, released July 1, 1996.

exchange and exchange access would produce serious systems problems and be inappropriate. Each Part 64 cost pool would have to be reexamined and further subdivided. Significant effort would have to be made to re-define costs pools and the application of allocators to those cost pools. The FCC should not utilize discarded video dialtone approaches in this regard.

Section 272(e)(3) requires that "[a] Bell operating company ... impute to itself (if using [exchange] access for its provision of its own service), an amount for access that is <u>no less than</u> the amount charged to any unaffiliated interexchange carriers for such service." [Emphasis added.] Treating interexchange service as nonregulated and the application of the Part 64 requirement that nonregulated services record the use of underlying tariffed services at tariff rates,[36] completely satisfy this provision, and ensure against any cross-subsidy or discrimination. Under Part 64, the same rules apply to regulated services provided to a nonregulated activity or nonregulated affiliate. There is no need for any additional accounting procedures to address any "differences ... between those rates and the costs [that would be] appropriately allocated...."[37] The use of tariff rate is a reasonable surrogate for cost, and use of the tariff rate mimics what the cost would be to any other provider of interexchange services. Finally, accounting for any such difference would not be in accordance with generally accepted accounting principles ("GAAP") which have been embraced by the Commission.[38]

---

36 <u>See</u> FCC Rules 32.27, 32.5280, 64.901.

37 NPRM ¶ 42.

38 <u>See e.g.</u>, 47 C.F.R. Section 32.16; <u>Use Of GAAP In Part 32</u>, RM-5835, 2 FCC Rcd 6675 (1987); <u>GAAP Order</u>, CC Docket No. 84-469, 50 F.R. 48408, November 25, 1985.

-- **Payphone Services:**

NYNEX agrees with the Commission's tentative conclusion that the accounting safeguards established in Computer Inquiry III[39] should be applied to the provision of payphone services by the BOCs, to the extent those safeguards have a relevant application in this context.[40] These safeguards, as well as those in the related BOC CPE Relief Order,[41] are more than sufficient to protect against cross-subsidization in the provision of payphone services. No other nonstructural safeguards are required. This is particularly so given that the issues raised by Section 276(b)(1)(C) are virtually identical to those the Commission addressed in Computer Inquiry III and in the CPE Orders. Payphones are merely a specialized type of CPE and, hence, there is no reason to believe that payphone services are any more susceptible to cross-subsidization than the competitive services successfully protected and promoted for years by virtue of those orders.

Regarding reclassification of payphone assets, NYNEX agrees with the Commission's tentative conclusion that the Commission must deregulate and detariff LEC payphone assets pursuant to Section 276.[42] As the Commission has correctly observed in the NPRM, this approach would require the LECs to reclassify payphone service as a nonregulated activity so that its costs are separated from the telephone exchange service and exchange access service that

---

39 See NPRM ¶ 28 & n. 38.

40 See NPRM ¶ 58.

41 Furnishing of Customer Premises Equipment by Bell Operating Telephone Companies and the Independent Telephone Companies, Report and Order, 2 FCC Rcd 143, 151-153 ¶¶ 50-70 (1987), recon., 3 FCC Rcd 22, 24 (1987), aff'd, Illinois Bell Telephone Co. v. FCC, 883 F.2d 104 (D.C. Cir. 1989).

42 See NPRM ¶ 59.

would continue to be regulated activities. NYNEX also agrees that the BOCs should continue to use Part 32 accounts to record their payphone service activities but only to the extent that they conduct those activities on an integrated basis. Where a BOC chooses to provide payphone services through a separate subsidiary, the subsidiary need not account for its activities under Part 32, but may do so at its option.

This approach mirrors the approach followed by the Commission in Computer Inquiry III and is, therefore, consistent with the mandate in Section 276 to prescribe nonstructural safeguards at least equal to those adopted in that proceeding. It will also prevent cross-subsidization.[43]

It bears emphasis that, as demonstrated in the RBOC Payphone Coalition's Comments in CC Docket No. 96-128,[44] payphone assets should be identified and valued consistent with FCC precedent, i.e., at net book value. Thus, for example, when a BOC like NYNEX proceeds to conduct nonregulated payphone activities on an integrated basis with regulated activities within the NYNEX Telephone Companies, FCC rules and precedent clearly provide for payphone assets to be reflected at net book value.[45]

---

[43] See CC Docket No. 96-128, Comments of the RBOC Payphone Coalition, July 1, 1996; Reply Comments of the RBOC Payphone Coalition, July 15, 1996. NYNEX is a member of that Coalition.

[44] See pp. 27-30 (incorporated by reference herein).

[45] See FCC Rules 32.14, 32.23, 32.27, 32.1406, 32.7990, 64.901; Joint Cost Reconsideration Order ¶ 122; Petition For Declaratory Ruling By The Inmate Calling Services Providers Task Force, RM-8181, Declaratory Ruling released February 20, 1996; Citizens Utils. Co. CAM, AAD 94-6, Order released April 22, 1996 (Com. Car. Bur.), ¶ 10; Procedures For Implementing The Detariffing Of CPE And Enhanced Services, 3 FCC Rcd 477 (1988) (BOCs required to detariff digital network channel terminating equipment ("NCTE," a form of CPE) at net book value).

Further, NYNEX recommends that the Commission require non-BOC local exchange companies to reclassify their payphone assets so as to require them to conduct their payphone operations on a deregulated basis. Indeed, the Commission tentatively concluded in CC Docket 96-128 that it "should treat incumbent LEC payphones as unregulated, detariffed CPE."[46] The Commission followed precisely that approach when it deregulated inmate payphone service (which is included in the definition of payphone service in Section 276(d)).[47] There is no reason to depart from these previous determinations particularly given the pro-competitive, deregulatory intent of the Act.

Regarding preemption, the Commission notes that Section 276(a)(1) prohibits subsidization of "payphone service directly or indirectly from . . . telephone exchange service operations or . . . exchange access operations"; and that Section 276(c) states: "[t]o the extent that any State requirements are inconsistent with the Commission's regulations, the Commission's regulations on such matters shall preempt such State requirements." The Commission invites comment on whether Congress intended to eliminate the Commission's ability to allow the States to depart from the federal cost allocation rules in their regulation of charges for or in connection with intrastate communications services.[48] NYNEX agrees with the FCC that the language in Section 276 is "clear" and unequivocal; i.e., it intends to eliminate the FCC's ability to permit inconsistent State cost allocation rules. Indeed, Section 276's above

---

[46] CC Docket 96-128, NPRM ¶ 42.

[47] See Petition For Declaratory Ruling By The Inmate Calling Services Providers Task Force, RM-8181, Declaratory Ruling released February 20, 1996.

[48] See NPRM ¶ 61.

language is self-executing so that the FCC's promulgation of a rule that is inconsistent with current or to-be-adopted State rules, in effect preempts the State rules. NYNEX incorporates the RBOC Payphone Coalition Comments in CC Docket 96-128 for a full statement of our proposed approach to setting the local coin rate pursuant to Section 276.

C. No New Accounting Rules Are Required With Respect To Separated Operations

As the Commission notes, Section 272(a)(2) allows BOCs to provide the following services only through a "separate affiliate": manufacturing of telecommunications equipment and CPE; origination of interLATA telecommunications services other than incidental, out-of-region, and previously authorized services; and interLATA information services other than electronic publishing and alarm monitoring services. The Commission also notes that Section 274(a) requires that BOCs providing electronic publishing must do so only through a "separated affiliate" or "electronic publishing joint venture."[49]

NYNEX concurs with the FCC's tentative conclusion that, "except where the 1996 Act imposes specific additional requirements, our current affiliate transactions rules generally satisfy the statute's requirement of safeguards to ensure that these services are not subsidized by subscribers to regulated telecommunications services."[50] As in the case of integrated operations, however, the Commission should avoid the imposition of additional, unnecessary affiliate transaction restrictions which "make it more difficult for a BOC or other incumbent local exchange carrier to capture the economies of scope that benefit both regulated and nonregulated

---

[49] See NPRM ¶ 62.

[50] See NPRM ¶ 64.

service subscribers,"[51] or discourage a BOC from entering new competitive lines of business (e.g., interLATA telecommunications).

Nevertheless, if the Commission adopts such additional restrictions, they should only apply with respect to affiliate transactions between the BOC and BOC-affiliated entities that engage in activities for which the Act mandates the use of a separate or separated affiliate.[52]

The Commission (NPRM ¶ 65) invites comment on whether, in implementing the Act's provisions regarding subsidization, the Commission should amend the current affiliate transactions rules to incorporate certain of the modifications proposed in the Affiliate Transactions Notice.[53] As discussed below, NYNEX believes no such amendments are warranted.

-- **Identical Valuation Rules For Assets And Services**:

The Commission states that, in light of its "experience" since the Joint Court Order, the Commission should consider prescribing uniform valuation methods for all affiliate transactions.[54] Under this approach, the Commission would apply identical valuation methods for assets and services. That is, if an inter-affiliate service is neither tariffed nor subject to a prevailing company price, carriers would be required to record the transaction at either net book cost or estimated fair market value, whichever benefits the telephone ratepayer.[55] The

---

[51] See NPRM ¶ 10.

[52] See NPRM ¶¶ 66, 89, 118.

[53] See CC Docket No. 93-251, NPRM, 8 FCC Rcd 8076 (1993).

[54] See NPRM ¶¶ 65, 77.

[55] See NPRM ¶¶ 76-78.